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Focus notes: Greece

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Budget execution data suggests 2010 fiscal deficit broadly in line with official target

Highlights

- **Reported acceleration of state budget revenue in December suggests government broadly on track to meet 2010 deficit target**

- **Greek Finance Minister categorically denies recent reports suggesting Greece is discussing debt restructuring with private creditors**

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Net ordinary budget revenue reportedly up 5.4% YoY in 2010

According to a finance ministry source quoted in a number of local papers and newswires earlier this week, net ordinary budget revenues grew by 5.4% YoY in the whole of 2010 against an official growth target of 6.0% YoY. In December, revenues rose by 10.6% YoY, bringing the corresponding full-year amount to €51.1bn. That leaves a shortfall of about €280mn *(~0.12%-of-GDP)* versus the revenue target for 2010. Note that the finance ministry has not yet published state budget execution data for the month of December. However, preliminary data for the first eleven months of last year showed a 27.4% YoY decline in the overall central government deficit on an accrual basis to €18.62bn, which compares with a full-year deficit reduction target of 33.2% YoY.

Specifically, gross ordinary budget revenue rose by 4.1% YoY year-to-November, with revenue net of tax returns recording a 4.8% YoY increase over the same period. The latter points to a notable acceleration in the pace of growth of budget receipts from 3.7% YoY in October, thanks to **a)** higher VAT revenue *(+11.1% YoY in November and +4.8%yoy in the first eleven months of 2010)*, **b)** some € 0.7bn in additional inflows to state coffers from the settlement of past tax obligations, **c)** a 33%YoY increase in custom revenues in November 2010 and **d)** the strengthening of government efforts in its fight against tax evasion. Reportedly, state budget revenue derived further support in December from a one-month extension in a special scheme to settle outstanding tax obligations to the state and the collection of annual vehicle excise tax duties.

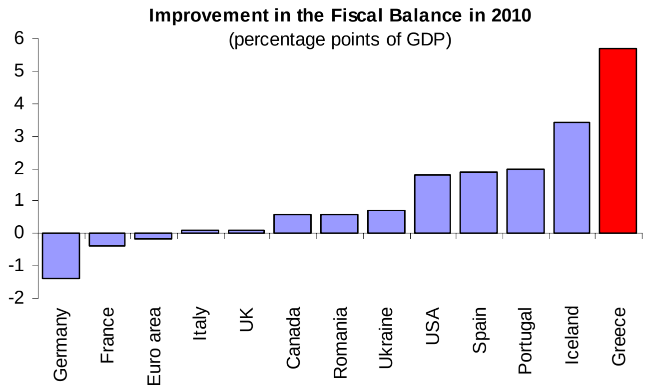
On the expenditure side, ordinary budget outlays decline by 6.5% YoY in January-November 2010, witch compares with a 7.5% YoY expenditure reduction target for the full year. Primary expenditure fell by €5.1 bn year-to-November, a decrease of 10.2% YoY compared with an annual target of -9.0% YoY. Interest costs continued to come below their full-year target for the second time in the last four months, recording a 5.7% YoY increase in January-November compared to an annual target of 7.6%YoY. Elsewhere, Public Investment Budget (PIB) revenues in the first eleven months of 2010 fell by €0.1bn or 6.8% YoY, which compares with an annual target for a 41.7% YoY decline. On the other hand, PIB outlays over the respective period fell by ca €1.0bn or 12.2% YoY vs. an annual target of -11.3% YoY. *Note that the above figures correspond to the execution of the* *state budget, which constitutes a subtotal of the overall general government budget (ESA-95 definition) that also includes such sub-national entities as local governments, state hospitals and a number of state-controlled enterprises.*

2010 state budget execution data broadly in line with full-year deficit target

A number of recent Eurostat revisions to Greece's 2006-2009 fiscal data revealed that the fiscal adjustment effort started from more elevated deficit and debt levels than thought earlier. The final data indicate that the 2009 deficit increased from 13.6% to 15.4% of GDP, and debt from 115% to 127% of GDP. The revisions, which were larger than expected, were primarily due to a reclassification of selected loss-making public enterprises into general government, improved data on pension arrears, and a number of other corrections in cash-to-accrual adjustments[1]. In response to these revisions, the Greek government upped its 2010 budget deficit forecast *(ESA-95 definition)* to 9.4% of GDP, from 7.8% of GDP expected earlier; the projection for the 2010 debt ratio was also revised upwards to 144.2% of GDP, from 132.7% expected earlier[1].

According to both the latest IMF country report on Greece and the European Commission's second review of the country's economic adjustment programme, Greece's general government budget deficit (in ESA95 terms) is projected to come in at 9.6%-of-GDP in 2010, *i.e.,* slightly above the government's revised target of 9.4%-of-GDP. In addition, according to a number of press reports recently circulating in the local press, the 2010 fiscal deficit could surprise to the upside, coming in as high as 10%-of-GDP. On a more positive note, it appears that the reported pickup in the growth of ordinary budget revenue in December raises optimism that the government managed to close 2010 budget broadly on target, with any realized overshooting of the overall fiscal deficit target *(€21.9bn)* likely to prove more contained than earlier feared. Upside risks to the final 2010 deficit outcome include, among others, **a)** a higher than expected contraction in domestic economic activity in Q4 2010 and **b)** a further significant accumulation in state arrears during the last months of 2010. According to the IMF, an estimated €2.2 billion *(~1%-of-GDP)* of arrears accumulated in the state budget over the first ten months of last year, largely as a result of spending overruns in local governments, hospitals and in social security funds[1]. On the other hand, such spending pressure is likely to be broadly offset by the under-execution of state spending *(~€2.5bn through to October)*, mainly as a result of lower military spending and social security transfers as well as reduced PIB outlays.

As an overall assessment of the government's fiscal consolidation effort so far, we broadly concur with the latest IMF appraisal of Greece's fiscal adjustment programme *(Country Report No. 10/372, Dec 2010)*. Namely despite recent revisions to past fiscal data, the overall fiscal adjustment has been quite significant in 2010, with the reduction in the overall budget balance expected to approach 6pp-pf-GDP. Note here that according to IMF staff estimates that some 8pp-of-GDP in structural revenue and expenditure measures had been implemented last year.



Source: IMF WEO October 2010

Reforms to fiscal institutions are making progress in some areas, but are encountering delays elsewhere. In order to address the revenue's shortfall mentioned above, the government will implement from January 2011 an anti-tax evasion plan which includes **a)** centralization of data collection, **b)** dedicated task forces focused on high-income individuals (earners) and firms, **c)** centralized taxpayer service directorate and **d)** centralization of filing enforcement and other medium term measures *(new legislation on risk based compliance framework etc)*. According to the IMF, even though these measures are considered adequate for the fight against tax evasion serious risks exist. Among others, these include **i)** too-long judicial appeal processes on tax disputes, **ii)** administrative obstacles, **iii)** inflexibility of the human resources and **iv)** ineffective dismissal procedures in case of fraud.

2011 budget appears austere enough to promote targeted adjustment

For 2011, the Greek government has constructed a budget that aims to fully offset the impact of the latest fiscal data revisions and achieve the 7.4%-of-GDP deficit target originally agreed with its official lenders under the present 3-year EU/IMF adjustment programme[1]. In nominal terms, the overall fiscal deficit is expected to decline to ca €16.8bn this year, from €21.9bn estimated in 2010 *(see 2011 budget)*. To assist attainment of the 2011 deficit target, the new budget incorporates a number of additional austerity measures *i.e.,* beyond these already included in the September 2010 update of the Memorndum of Understanding (MoU) with the

EC/ECB/IMF. The government estimates these additional measures to be worth 2.7pp-of-GDP, bringing the total expected size of the 2011 austerity package to slightly over 7pp-of-GDP *(=2.7pp-of-GDP + 2.4pp-of-GDP carry over from measures implemented during 2010 + 2.3pp-of-GDP measures for 2011 incorporated in the September 2010 MoU).*

The above figures suggest that, baring any unforeseen macroeconomic or political developments and assuming full implementation of the 2011 budget, the government should be able to attain the 2pp-of-GDP targeted reduction in the fiscal deficit this year. In support of the latter view note that the overall size of the fiscal adjustment package for 2011 appears adequate enough to largely offset the drag from a *(downwardly)* revised macroeconomic outlook, structural spending pressures stemming from higher interest costs, the expiration of a number one-off measures implemented in 2010 *(e.g. the levies on high income individuals)*, and some new fiscal initiatives introduced by the authorities to support growth and the unemployed *(e.g. selected corporate and VAT cuts and a new jobs program)*. Moreover, the lifting of reservations on Greece's fiscal accounts in Eurostat's November 2010 notification, effectively means that any further revisions to the country's past fiscal data would not be due to methodological factors and thus, not nearly as significant in magnitude as the revisions instrumented in the recent past.

With regards to the 2014 government deficit target of less than 3.0% of GDP, the revised MoU envisages that ca 5.0%-of-GDP or ca €12bn of (yet unidentified) measures need to be specified. The government is expected by March 2011 to unveil these measures, as well as a complete plan of fiscal adjustment for the period 2011-2014, in line with the Financial Management law adopted last July.

Greek Finance Minister categorically denies recent reports suggesting Greece is discussing debt restructuring with private creditors

In an interview to Reuters on January 4, Greece's Finance Minister George Papaconstantinou expressed confidence that the country will be able to stir through the debt crisis and that it will continue receiving the upcoming EU/IMF financial aid tranches. More importantly, Mr. Papaconstantinou categorically denied rumors recently circulated in the local media suggesting that Greek officials, including Prime Minister Advisor Loukas Papademos and Central Bank Governor Georges Provolpoulos, were holding unofficial discussions with EU authorities and private creditors on a restructuring of the Greek debt after 2013. According to the aforementioned report published in late December, the plan included two main pillars. Firstly, an extension of debt repayments not only of the financial aid received from the Troika, but of loans owed to private-sector creditors. Secondly, the Greek government would request a reduction of the interest rates on these loans, without seeking haircuts on the value of its bonds. Nevertheless, in his Reuters' interview, Greek Finance Minister rebuffed speculation about discussions of debt restructuring adding that Greece was not in talks with private-sector creditors to extend debt repayments. He also said that around EUR 7bn are seen generated from privatization revenues in 2011-13 and signaled that the government plans to toughen tax evasion rules by February. Papaconstantinou also said that the 2010 fiscal deficit was in line with the target adding that reforms were on schedule and that the government is sticking to its earlier plans to return to the bond markets sometime this year.

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